

HELVERING, COMMISSIONER OF INTERNAL
REVENUE, *v.* POWERS, EXECUTOR, ET AL.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE
FIRST CIRCUIT.

No. 17. Argued October 12, 15, 1934.—Decided December 3, 1934.

1. The provision of the Revenue Acts of 1926, §§ 212 (a), 213 (a), and 1928, §§ 21, 22 (a), for taxing income derived "from compensation for personal service . . . of whatever kind and in whatever form paid," is broad enough to embrace the compensation of state officers if not constitutionally immune. P. 224.
2. A Treasury Regulation cannot limit this statutory provision or define the boundaries of its constitutional application. *Id.*
3. Constitutional immunity of the compensation of a state officer from federal taxation is not a necessary result of his being a state officer; it depends upon the nature of the political activities assigned to him and upon whether they come within the fundamental reason for denying federal authority to tax, viz., necessary protection of the independence of national and state governments in their respective spheres in our constitutional system. P. 224.
4. One of the limitations of the principle of tax immunity as between the state and national governments is that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which go beyond usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend. P. 225.
5. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. *Id.*
6. In operating a street railway, whether permanently or for a limited time, the State is undertaking a business enterprise of a sort that is normally within the reach of the federal taxing power and is distinct from the usual governmental functions that are immune from federal taxation in order to safeguard the necessary independence of the State. P. 227.
7. If a business undertaken by a State is not immune from a federal excise tax upon its operations, the compensation of those who conduct it for the State is not exempt from a federal income tax. P. 227.

8. A street railway company and its properties, including a reserve fund, are taken over by the State, to be publicly operated and managed for a limited period of time, pursuant to a special Act of the Legislature agreed to by the company. The operations during that period are to be under the exclusive control of a board of trustees, who are officers of the State specially appointed for the purpose, and the management is to be such that the cost of the venture, including operating expenditures, upkeep and other charges against income and surplus, with dividends agreed to be paid on the company's stock, shall be met by the income; but if there are deficits, these are to be paid by the State and assessed against the towns and cities along the railway. At the end of the period, the properties are to be restored to the company in good condition and the fund undiminished. The salaries of the trustees, fixed by the statute, are payable by the company,—part of the costs of operation. As incidents of the main purpose, the trustees have exclusive authority to regulate and fix the fares and to ascertain any losses incurred, which are to be borne by the State.

Held that the salaries of the trustees are not constitutionally immune from income tax under the Federal Revenue Acts of 1926 and 1928.

68 F. (2d) 634, reversed.

CERTIORARI, 292 U. S. 620, to review a judgment reversing a decision of the Board of Tax Appeals sustaining a deficiency assessment of income tax.

Solicitor General Biggs, with whom *Assistant Attorney General Wideman* and *Messrs. Erwin N. Griswold, James W. Morris, and John MacC. Hudson* were on the brief, for petitioner.

The statute imposes a tax upon the income of every individual derived from compensation for service and from all sources whatsoever.

The doctrine of implied constitutional immunity from taxation is limited to the agencies and instrumentalities exercising strictly governmental functions. The reason for the rule must control. Exemption must depend upon the effect of the tax upon the exercise by the State of its essential functions of Government, although consideration

should also be given to the inherent nature of the agency taxed, and its relation to Government.

The trustees were appointed solely for the purpose of managing and operating the railway and, to the end that adequate transportation service might be maintained, were authorized to fix rates of fare sufficient to meet the cost of service.

It is no part of the essential governmental functions of a State to furnish means of transportation to its people. When a State departs from those functions and engages in a business of a purely private nature, the business and the instrumentalities employed therein are subject to a non-discriminatory tax imposed by the Federal Government.

The provisions of the Treasury regulations as to the compensation of "officers" are valid and applicable. The court below held that the trustees were officers of the State and that there is no basis for the requirement of the regulations that the compensation must be received for services rendered in the exercise of governmental functions. In so holding, the court either ignored or overlooked explicit and well-known decisions of this Court. *Flint v. Stone Tracy Co.*, 220 U. S. 107; *South Carolina v. United States*, 199 U. S. 437; *Ohio v. Helvering*, 292 U. S. 360.

The fact that the respondents had the power to fix rates, and to declare deficits, which were used as a basis of taxation, is not sufficient to exempt from taxation the salaries which they received for managing the railroad. The respondents had no discretion in fixing rates, and they had no power to levy taxes. Their authority with respect to each was merely ministerial.

Moreover, the compensation received by the respondents was not paid for the exercise of these powers. The salaries were paid to the trustees by the company and not by the Commonwealth; and they were paid for their services as managers of the company. If the respondents exercised any essential governmental powers, they re-

ceived no compensation on that account; and their compensation received for other services is not exempt.

Even if the salary paid by the company could be regarded as paid in part as compensation for essentially governmental service on behalf of the State, the entire amount would not be exempt. And there can be no allocation, for they have produced no evidence of the proper basis of allocation.

Mr. Melville Fuller Weston, with whom *Mr. J. Colby Bassett* was on the brief, for respondents.

It is of the very essence of a Government to be able to personify itself in public officers, and through them to manifest in action the policies, within its lawful powers, upon which it has determined through its legislative branch. Hence a public officer, and especially a primary officer, is an essential instrumentality of Government, and to have such officers is in itself an essential function of Government.

This Court has on frequent occasions discussed the scope of the constitutional principle of exemption and has on no occasion failed to place public officers, as such, among those instrumentalities of Government, which are "essential." It has never been intimated that public officers were to be classified according to the nature of the subject matter to which their duties pertained, as essentially governmental officers, officers not essentially governmental, and officers having duties partly governmental and partly not. *Willcuts v. Bunn*, 282 U. S. 216, 225-6; *Indian Motorcycle Co. v. United States*, 283 U. S. 570, 577; *Flint v. Stone Tracy Co.*, 220 U. S. 107; *South Carolina v. United States*, 199 U. S. 437; *Ohio v. Helvering*, 292 U. S. 360; *Georgia v. Chattanooga*, 264 U. S. 472; *Bank of United States v. Planters Bank*, 9 Wheat. 904; *Bank of Kentucky v. Wister*, 2 Pet. 318; *Briscoe v. Bank of Kentucky* 11 Pet. 257; *Curran v. Arkansas*. 15

How. 304; *North Dakota v. Olson*, 33 F. (2d) 848, dismissed for want of jurisdiction, 280 U. S. 528; *United States v. Baltimore & Ohio R. Co.*, 17 Wall. 322.

The compensation of a public officer is the means of obtaining his services. It has never been suggested that it is any less the means because paid by fees or from some source other than public funds which the State was competent to command. Still less has it ever been suggested that it is subject to an artificial "allocation" upon the basis of a classification of duties. It is wholly exempt. The Treasury Department itself has long recognized that, in the case of a public officer, the source of the emolument fixed by law was not material. See, for example, 5 C. B. 106 (fees of deputy sheriffs); II-1 C. B. 71 (compensation of state employees under Sheppard-Towner Act); II-1 C. B. 72 (fees of public administrators paid out of the estates); IV-2 C. B. 46 (receivers of insolvent state banks paid out of bank assets).

Once it is established that the constitutional principle applies, "It is not affected by the amount of the particular tax or the extent of the resulting interference, but is absolute." *Indian Motorcycle Co. v. United States*, 283 U. S. 570, 575.

The respondents were public officers and were, moreover, primary officers. The State spoke through the legislature, but when it came to act, it acted first through them. Their compensation fell within the constitutional principle, notwithstanding the State procured it to be paid in the first instance out of a private fund, the integrity of which fund, however, the State had agreed to underwrite.

Upon the basis of decisions dealing solely with excise taxes levied upon business activities, and not with direct taxes levied upon public offices or their emoluments, the petitioner seeks to exclude the respondents from the scope of the exemption. It is submitted that the cases are wholly distinguishable. A State cannot raise a private

business to its own level; but, at its own level, it is competent to develop a public policy even with respect to its relations to a private business, and it has a constitutional right to have public officers through whom to act in respect of a public policy coming within its lawful powers.

Even if the respondents' duties be scrutinized as to their subject matter, there appears no sufficient ground for making of them an exception to the heretofore absolute rule exempting from federal taxation the compensation of public officers of a State.

On the question whether providing means of transportation is a genuine and long established subject matter of Government, the weight of the later cases, despite the dictum in *Flint v. Stone Tracy Co.*, seems to be in the affirmative. *Jamestown & Newport Ferry Co. v. Commissioner*, 41 F. (2d) 920; *United States v. King County*, 281 Fed. 686; *Frey v. Woodworth*, 2 F. (2d) 725; *Moisseiff v. Commissioner*, 21 B. T. A. 515; *Seattle v. Poe*, 4 F. (2d) 276; *Lyons v. Reinecke*, 10 F. (2d) 3; *Blair v. Byers*, 35 F. (2d) 326; *Cleveland Ry. Co. v. Commissioner*, 36 F. (2d) 347.

Governments have concerned themselves for centuries, and not by regulation alone, with the means of transportation. The respondents, while very likely not in the exercise of the "police power," dealt extensively with a common subject matter of public regulation, and acted in the identical interest in which public regulation is exerted, and to the same substantial ends. They were, moreover, charged with the apportionment of a heavy burden of state taxation.

There is undoubted force to the argument that indefinite expansion of the functions of one Government cannot be allowed to withdraw all activities within its borders from the taxing power of the other. See *South Carolina v. United States*, 199 U. S. 437, 454. But we are not discussing the taxability of the railroad property, or of

the railroad income, or of the compensation of employees of the railroad company. We are asserting that there is nothing so violently nongovernmental about the subject matter of providing means of transportation as to require the modification of the absolute rule with respect to the exemption of public officers' compensation, as repeatedly stated by this Court.

MR. CHIEF JUSTICE HUGHES delivered the opinion of the Court.

The question presented is whether the compensation of the members of the Board of Trustees of the Boston Elevated Railway Company is constitutionally exempt from the imposition of a federal income tax. Immunity is sought upon the ground that the trustees are officers of the Commonwealth of Massachusetts and instrumentalities of its government. The Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals, held in favor of the exemption. 26 B. T. A. 1381; 68 F. (2d) 634. We granted a writ of certiorari. 292 U. S. 620.

Chapter 159 of the Massachusetts Special Acts, 1918, provides for the public operation of the Boston Elevated Railway Company. The Act creates a board of five trustees, to be appointed by the Governor, with the advice and consent of the Council, for the term of ten years. The Act provides that the trustees shall be sworn before entering upon their duties; they shall own no stock or other securities of the Company and shall each receive from the Company \$5,000 annually as compensation for his services. They are subject to removal by the Governor with the advice and consent of the Council.

The trustees are charged with the duty of managing and operating the Company and its properties for the period, as stated or extended, of public operation, and to that end are to have "possession of said properties in be-

half of the Commonwealth." Except as otherwise stated, they are to exercise all the powers of the Company, being empowered in their discretion to appoint and remove the president and other officers of the Company, except the directors. The trustees are authorized "to regulate and fix fares" and "to determine the character and extent of the service and facilities to be furnished." Their authority for this purpose is made "exclusive" and is not "subject to the approval, control or direction of any other state board or commission." The Act provides that the trustees and their employees shall be deemed to be acting as agents of the Company and not of the Commonwealth, and that the Company shall be liable for their acts and negligence to the same extent as if they were in the immediate employ of the Company, but that the trustees shall not be personally liable.

The Company was required, on or before its acceptance of the Act, to raise a stated amount by the issue of preferred stock in order to provide for the improvement of the property of the Company and the establishment of a reserve fund. The trustees are to fix such rates of fare as will reasonably insure sufficient income to meet the cost of service, as defined, which, in addition to operating expenditures, outlays for the required upkeep of the properties, and other amounts chargeable against income and surplus, includes fixed dividends on the preferred stock and dividends on the common stock at specified rates. Surplus income is to be transferred to the reserve fund and that fund is to be used to meet deficiencies. If it is insufficient for that purpose, the trustees are required to notify the treasurer and receiver general of the Commonwealth, and the Commonwealth is to pay the amount of the deficit ascertained according to the Act. Amounts thus paid are to be assessed upon the several cities and towns in which the Company operates. Provision is

made for reimbursement out of subsequent surplus income. The Act contemplates the maintenance of the property in good operating condition and the restoration of the reserve fund, if depleted, to its original amount on the expiration of the period of public management. At that time the control of the property is to revert to the Company. It may then collect such reasonable fares as will produce an income sufficient to pay the reasonable cost of the service as defined in the Act, including specified dividends on the common stock, and the Company is then to be subject to public regulation in such manner as may be determined by the General Court, but not so as to reduce the income below the cost of the service as stated.

The tax in question was on the compensation received by the trustees for the years 1926 to 1929. It appears that in 1919 the Commonwealth paid to the Company nearly \$4,000,000 as a deficiency resulting from the public operation, and that in subsequent years, up to and including 1929, the income received was not sufficient for full reimbursement.

The validity of the statute has been sustained as one enacted for a public purpose and providing for the management of the enterprise by the Commonwealth. *Boston v. Treasurer & Receiver General*, 237 Mass. 403, 413, 420; 130 N. E. 390; *Boston v. Jackson*, 260 U. S. 309, 314, 316. The Supreme Judicial Court of Massachusetts has characterized the "public operation" as "undertaken by the Commonwealth, not as a source of profit, but solely for the general welfare." *Boston v. Treasurer & Receiver General*, *supra*. The trustees are the administrative agents of the Commonwealth in this enterprise, and we may assume, as the Circuit Court of Appeals has held, that the trustees come within the general category of "public officers" by virtue of their appointment by the

Governor, with the advice and consent of the Council, and their tenure and duties fixed by law.¹ *United States v. Hartwell*, 6 Wall. 385, 393; *Metcalf & Eddy v. Mitchell*, 269 U. S. 514, 520. See *Opinion of the Justices*, 261 Mass., pp. 542, 543, 550; 159 N. E. 55.

While the undertaking is for the public benefit, it is still a particular business enterprise—the operation of a street railway—and the functions of the trustees are limited accordingly. The property remains in private ownership. The Act, accepted by the Company, constitutes in substance an agreement between the Company and the Commonwealth that the latter shall temporarily take over the management and operation and pay specified amounts by way of compensation. While the Commonwealth may be called upon to bear losses that may occur, if the fares as fixed prove to be insufficient, the operation by the trustees is intended to be self-sustaining. The transportation service is to be rendered, as respondents' counsel say, "under such a flexible system of rate-making as would allow the fixing of fares equal, as nearly as might be, to the cost of service." The compensation of the trustees is undoubtedly a part of that cost. "The main design of the Act," as stated by the Supreme Judicial Court, "is public operation of the railway company at such rates of fare to be fixed by the trustees from time to time as shall afford revenue sufficient to defray all charges and the dividends established by the act." *Boston v. Treasurer & Receiver General*, *supra*. The authority given to the trustees "to regulate and fix fares," and

¹ The provision of § 1 of Chapter 159 of the Massachusetts Special Acts of 1918 that the trustees shall not be considered public officers within the meaning of § 25 of Chapter 514 of the Acts of 1909, and that § 1 of Chapter 7 of the Revised Laws shall not apply to the trustees, creates special limitations of such a nature as not to derogate from their general status. See *Opinion of the Justices*, 261 Mass., p. 543; 159 N. E. 55.

the further authority to ascertain such losses as may be incurred, which are to be borne by the Commonwealth, are both incident to that main purpose.

The immunity sought by the trustees from payment of the federal income tax has not been granted by the Congress. The definitions of income in the federal income tax acts cover income derived "from compensation for personal service . . . of whatever kind and in whatever form paid." Revenue Acts of 1926, §§ 212 (a), 213 (a); 1928, §§ 21, 22 (a). This language is certainly broad enough to embrace the compensation of the trustees, and the immunity, if it exists, must rest upon constitutional limitation. The Treasury Regulations, manifestly in an effort to interpret and apply that limitation, provide for exemption from taxation of compensation paid by a State or political subdivision to its officers and employees only in case their services are rendered "in connection with the exercise of an essential governmental function." Treas. Reg. No. 69, Art. 88; No. 74, Art. 643; No. 77, Art. 643. But the Treasury Department could not by its regulation either limit the provisions of the statute or define the boundaries of their constitutional application.

We come then to the question whether the Congress has the constitutional power to impose an income tax upon the compensation of public officers of the character here involved. We do not regard that question as answered by mere terminology. The roots of the constitutional restriction strike deeper than that. The term "public office" undoubtedly implies a definite assignment of public activity, fixed by appointment, tenure and duties. But whether that field of activity, in relation to a State, carries immunity from federal taxation is a question which compels consideration of the nature of the activity, apart from the mere creation of offices for conducting it, and of the fundamental reason for denying

federal authority to tax. That reason, as we have frequently said, is found in the necessary protection of the independence of the national and state governments within their respective spheres under our constitutional system. *Collector v. Day*, 11 Wall. 113, 125, 127; *Ambrosini v. United States*, 187 U. S. 1, 7; *Indian Motorcycle Co. v. United States*, 283 U. S. 570, 575. The principle of immunity thus has inherent limitations. *Metcalf & Eddy v. Mitchell*, *supra*, pp. 522-524; *Willcuts v. Bunn*, 282 U. S. 216, 225, 226; *Indian Motorcycle Co. v. United States*, *supra*, p. 576; *Fox Film Corp. v. Doyal*, 286 U. S. 123, 128; *Board of Trustees v. United States*, 289 U. S. 48, 59. And one of these limitations is that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. *South Carolina v. United States*, 199 U. S. 437; *Flint v. Stone Tracy Co.*, 220 U. S. 107, 172; *Murray v. Wilson Distilling Co.*, 213 U. S. 151, 173; *Metcalf & Eddy v. Mitchell*, *supra*; *Indian Motorcycle Co. v. United States*, *supra*; *Ohio v. Helvering*, 292 U. S. 360, 368, 369. The necessary protection of the independence of the state government is not deemed to go so far.

In *South Carolina v. United States*, *supra*, the State undertook to establish a monopoly of the sale of intoxicating liquors and prohibited the sale except by dispensaries to be operated by the State. The dispensers had no interest in the sales and received no profit from them. The question was whether the dispensers were relieved from liability for the internal revenue tax prescribed by the Congress for dealers in intoxicating liquors because the

dispensers were agents of the State, which in the exercise of its sovereign power had taken charge of the business. While the court recognized the power of the State to undertake the enterprise, the exemption was denied, as the State could not, by engaging in a business of that sort, withdraw it from the taxing power which the Constitution vested in the national government. *Murray v. Wilson Distilling Co.*, *supra*.

The Court reached a similar conclusion in the recent case of *Ohio v. Helvering*, *supra*, where the State had established a department of liquor control and sought an injunction to restrain the enforcement of federal statutes imposing taxes upon dealers in intoxicating liquors. The State sought to distinguish the case of South Carolina because, in Ohio, "the state-owned stores" were operated by civil service employees of the state government, and hence the question was said to concern the taxation of the State itself. The argument was unavailing and the Court rested its ruling upon the broad ground that when the State becomes a dealer in intoxicating liquors it falls within the reach of the tax as one validly imposed by the federal statute.

The method which the State may adopt in organizing such an activity cannot be regarded as determinative. If the dealers in South Carolina, or those employed to operate the state stores in Ohio, had been denominated public officers, and as such had been assigned definite tenure and duties, the same result would have been reached, as the principle involved would be equally applicable. Nor, in such a case, would the fact that the officers were entrusted with the authority to fix prices for the sales under their charge in a manner appropriately to secure the revenue needed for the enterprise, or were charged with the duty of ascertaining the losses which, if they occurred, were to be borne by general taxation, establish a material distinction.

The nature of the enterprise, and not the particular incidents of its management, would control.

We see no reason for putting the operation of a street railway in a different category from the sale of liquors. In each case, the State, with its own conception of public advantage, is undertaking a business enterprise of a sort that is normally within the reach of the federal taxing power and is distinct from the usual governmental functions that are immune from federal taxation in order to safeguard the necessary independence of the State. If, in the instant case, the Commonwealth had acquired the property of the Company and had organized management of it in perpetuity by the state government, instead of temporarily, or had taken over all the street railways in all its cities for direct operation by the Commonwealth, there would appear to be no ground, under the principles established by the decisions we have cited, for holding that this would effect the withdrawal of the enterprise from the federal taxing power. And the fact that the State has here undertaken public management and operation for a limited time, and under the particular restrictions of the agreement with the Company, cannot be said to furnish a ground for immunity.

If the business itself, by reason of its character, is not immune, although undertaken by the State, from a federal excise tax upon its operations, upon what ground can it be said that the compensation of those who conduct the enterprise for the State is exempt from a federal income tax? Their compensation, whether paid out of the returns from the business or otherwise, can have no quality, so far as the federal taxing power is concerned, superior to that of the enterprise in which the compensated service is rendered.

We conclude that the Congress had the constitutional authority to lay the tax.

Decree reversed.